



OFFICE OF
INSURANCE COMMISSIONER

In the Matter of

No. G 03-78

The Financial Examination of
**SAFECO INSURANCE COMPANY
OF AMERICA**
A Domestic Insurer.

FINDINGS, CONCLUSIONS, AND ORDER ADOPTING REPORT OF FINANCIAL EXAMINATION

BACKGROUND

An examination of the financial condition of **SAFECO INSURANCE COMPANY OF AMERICA** (the Company) as of December 31, 2000, was conducted by examiners of the Washington State Office of the Insurance Commissioner (OIC). The Company holds a Washington certificate of authority as a stock insurer. This examination was conducted in compliance with the laws and regulations of the state of Washington and in accordance with the procedures promulgated by the National Association of Insurance Commissioners and the OIC.

The examination report with the findings, instructions, and comments and recommendations was transmitted to the Company for its comments on June 11, 2003. The Company's response to the report is attached to this order only for the purpose of providing convenient review of the response.

The Commissioner or a designee has considered the report, the relevant portions of the examiners' work papers, and submissions by the Company.

Subject to the right of the Company to demand a hearing pursuant to Chapters 48.04 and 34.05 RCW, the Commissioner adopts the following findings, conclusions, and order.

FINDINGS

Findings in Examination Report. The Commissioner adopts as findings the findings of the examiners as contained in pages 2 through 57 of the report.

CONCLUSIONS

It is appropriate and in accordance with law to adopt the attached examination report as the final report of the financial examination of **SAFECO INSURANCE COMPANY OF AMERICA** and to order the Company to take the actions described in the Instructions and Comments and Recommendations sections of the report. The Commissioner acknowledges that the Company may have implemented the Instructions and Recommendations prior to the date of this order. The Instructions and Recommendations in the report are an appropriate response to the matters found in the examination.

ORDER

The examination report as filed, attached hereto as Exhibit A, and incorporated by reference, is hereby ADOPTED as the final examination report.

The Company is ordered as follows, these being the Instructions and Comments and Recommendations contained in the examination report on pages 3 through 22.

1. Our examination of the Company disclosed numerous areas in which the Company's accounts and records were found to be deficient, insufficient, or inaccurate to provide for and ensure full and adequate disclosure. The Company is ordered to comply with RCW 48.05.280 which requires the Company to keep full and adequate accounts and records of its assets, obligations, transactions and affairs. This order is specifically relevant to each of the following:

Instruction 1 – Inadequate Accounts and Records – Examination Report, page 3.

Instruction 5 – Holding Company Securities Transactions Reporting –
Examination Report, page 6.

Instruction 7 – Promissory Note from Affiliate – Examination Report, page 9.

Instruction 10 – Stock Valuation – Examination Report, page 12.

Instruction 12 – Cash and Short-Term Investments – Examination Report, page
15.

Instruction 13 – Other Invested Assets – Examination Report, page 15.

Instruction 14 – Receivable/Payable for Securities – Examination Report, page
16.

Instruction 15 – Agents' Balances or Uncollected Premiums – Examination
Report, page 16.

Instruction 20 – Safekeeping of Securities, Examination Report, page 19.

Instruction 21 – Incomplete and Incorrect Finance Committee Minutes – Examination Report, page 19.

2. The Company is ordered to fully comply with RCW 48.05.250 which requires the Company to file a true statement of its financial condition, transactions, and affairs. This order is specifically relevant to each of the following:

Instruction 5 – Holding Company Securities Transactions Reporting – Examination Report, page 6.

Instruction 6 – Errors in Annual Statements – Examination Report, page 8.

Instruction 7 – Promissory Note from Affiliate – Examination Report, page 9.

Instruction 9 – Bonds Pledged for Letter of Credit – Examination Report, page 12.

Instruction 10 – Stock Valuations – Examination Report, page 12.

Instruction 12 – Cash and Short-Term Investments – Examination Report, page 15.

Instruction 13 – Other Invested Assets – Examination Report, page 15.

Instruction 14 – Receivable/Payable for Securities – Examination Report, page 16.

Instruction 15 – Agents' Balances or Uncollected Premiums – Examination Report, page 16.

Instruction 16 – Accrued Interest on Investments- Examination Report, page 17.

Instruction 17 – Prepaid Guaranty Fund Surcharges – Examination Report, page 18.

Instruction 18 – Unsecured Advances to Agents – Examination Report, page 18.

Instruction 19 – SAFECO UK Limited Capacity Purchase – Examination Report, page 18.

Instruction 22 – Investment in Impact Promissory Notes – Examination Report, page 20.

3. The Company is ordered to make provision for the examination adjustments to its loss and loss adjustment expense reserves which will place the Company in compliance with RCW 48.12.030(2), which provides that the Company estimate its provision to pay its unpaid losses and claims incurred on or prior to the date of the annual statement together with the expense of adjustment or settlement thereof. Instruction 2, Examination Report, page 5.

4. The Company is ordered to comply with RCW 48.13.290(1) which states, "Any ineligible personal property or securities acquired by an insurer may be required to be disposed of within the time not less than six months specified by order of the commissioner, unless before that time it attains the standard of eligibility. . . ." Under this Examination Order, the Company will be required to dispose of ineligible foreign securities in a time frame as specified under Special Consent Order No. 96. (See item No. 1 under "SUBSEQUENT EVENTS" for a description of special consent order No. 96) Instruction 3, Examination Report, page 6.
5. The Company is ordered pursuant to RCW 48.31B.030(1)(b)(iv) to submit for approval to the Washington Insurance Commissioner's Office an inter-company agreement with SAFECO Asset Management Company and all pertinent affiliates which complies with RCW 48.31B.030(1)(a). Instruction 4, Examination Report, page 6.
6. The Company is ordered to comply with RCW 48.31B.030(1)(b)(i) and 48.31B.025 which requires the filing of insurance holding company reports detailing transactions with parent companies, subsidiaries and affiliates. Instruction 5, Examination Report, page 8.
7. The Company is ordered to comply with RCW 48.13.110(1)(a) and 48.13.120(1) in listing and valuing its investment in the promissory note that is secured by a deed of trust. The Company is ordered to comply with RCW 48.31B.025 which requires the filing of insurance holding company reports detailing transactions with parent companies, subsidiaries and affiliates. The Company is ordered to comply with RCW 48.13.340 which requires the authorization or approval by the Company's board of directors. The Company is ordered to comply with RCW 48.13.350 which requires that the Company keep full and adequate accounts and records of its investments. Instruction 7, Examination Report, page 11.
8. The Company is ordered to correct and maintain amortization schedules on individual investments that will tie to the amortization reported in Schedule D of its annual statement and is ordered to comply with RCW 48.12.170(1)(b) which provides that bonds or evidences of debt having a fixed term and rate purchased above or below par shall be valued on the basis of the purchase price adjusted so as to bring the value to par at the earliest date callable at par or maturing at par or in lieu of such method, according to such accepted method of valuation as is approved by the commissioner. Instruction 8, Examination Report, page 11.

9. The Company is ordered to comply with RCW 48.12.010 which provides that the Company is allowed only such assets as belong wholly and exclusively by the Company. Instruction 9, Examination Report, page 12.
10. The Company is to comply with RCW 48.31B.030(1)(b)(i) and 48.31B.025 which requires the accurate filing of insurance holding company reports detailing transactions with parent companies, subsidiaries and affiliates. Instruction 9, Examination Report, page 12.
11. The Company is ordered to review investments to maintain compliance with Chapter 48.13 RCW and non-admit securities that do not meet the standards and requirements set forth therein. This will ensure compliance with RCW 48.12.180(1) which provides that the Company shall value its securities at market value and with RCW 48.13.050(1) which provides for investment in corporate obligations. Instruction 10, Examination Report, page 12.
12. The Company is ordered to comply with RCW 48.12.010 and RCW 48.12.180(3)(a) for the valuation of all subsidiaries. Instruction 11, Examination Report, page 15.
13. The Company is ordered to put in place controls to properly monitor and report accurately receivables/payables of securities to comply with WAC 284-07-050 which requires each authorized insurer to file an annual statement in the form and context as promulgated by the NAIC. Instruction 14, Examination Report, page 16.
14. The Company is ordered to comply with RCW 48.12.010(5) and (10) in the determination of the admissibility of agents' balances or uncollected premiums.. Instruction 15, Examination Report, page 17.
15. The Company is ordered to comply with RCW 48.12.020 which provides that prepaid expenses shall not be allowed as assets in the determination of the financial condition of an insurer. Instruction 17, Examination Report, page 18.
16. The Company is ordered to comply with RCW 48.12.020(3) which provides that unsecured advances to agents shall not be allowed as assets in the determination of the financial condition of an insurer. Instruction 18, Examination Report, page 18.
17. The Company is ordered to comply with RCW 48.12.020 which provides that unsecured advances to agents shall not be allowed as assets in the determination of the financial condition of an insurer. Instruction 19, Examination Report, page 19.

18. The Company is ordered to use due care and diligence in the tracking and oversight of custodial arrangements entered into in order. The Company is also ordered to maintain compliance with NAIC guidelines. Instruction 20, Examination Report, page 19.

19. The Company is ordered to comply with RCW 48.13.340 which provides that no investment, sale or exchange shall be made by any domestic company unless authorized or approved by its Board of Directors or by a committee charged by the Board of Directors or the Bylaws with the duty of making such investment, sale or exchange. The Company is ordered to comply with RCW 48.13.350 which provides a record of the earnings on investments. Instruction 21, Examination Report, page 20.

20. The Company is ordered to comply with RCW 48.13.050 regarding investment in corporate obligations which are secured by adequate collateral security and bear fixed interest during each of any three, including the last two of the five fiscal years next preceding the date of acquisition by the insurer. Instruction 22, Examination Report, page 21.

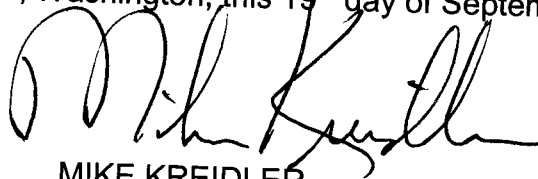
21. The Company is ordered to adopt individual investment guidelines that cover the investment requirements in the Washington Insurance Code. Comments and Recommendations 1, Examination Report, page 21.

22. The Company is ordered to adhere to the Securities Lending Agreement with The Bank of New York and require The Bank of New York to obtain the necessary collateral level on foreign securities. Comments and Recommendations 2a, Examination Report, page 22.

23. The Company is ordered to loan securities only to the brokers listed in Schedule 1 of the 1999 Agreement or amend Schedule 1 as the names of approved brokers change or new brokers are added. Comments and Recommendations 2b, Examination Report, page 22.

IT IS FURTHER ORDERED THAT, the Company file with the Chief Examiner, within 90 days of the date of this order, a detailed report specifying how the Company has addressed each of the requirements of this order.

ENTERED at Tumwater, Washington, this 19th day of September, 2003.

A handwritten signature in black ink, appearing to read "Mike Kreidler", written over the printed name.

MIKE KREIDLER
Insurance Commissioner



RECEIVED
JUL 16 2003

INSURANCE COMMISSIONER
COMPANY SUPERVISION

SAFECO INSURANCE COMPANY OF AMERICA

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July 14, 2003

CONTINUED

Mr. James T. Odiorne, CPA, JD
Deputy Insurance Commissioner
Company Supervision Division
Office of the Insurance Commissioner
P. O. Box 40255
Olympia, WA 98504-0255

Re: Examination Report of Safeco Insurance Company of America
as of December 31, 2000

Dear Mr. Odiorne:

Enclosed are Safeco's responses to the draft reports of examination. Do not hesitate to contact me if questions or concerns arise in the course of your review.

We would like to take this opportunity to express our appreciation for the professionalism demonstrated by the Department staff. We appreciate having had the opportunity to work with them.

Sincerely,

Laura M. Murphy
Vice President and Associate General Counsel

Enc.

SAFECO INSURANCE COMPANY OF AMERICA
("the Company")

COMPANY RESPONSES

Safeco Insurance Company of America has reviewed the Instructions, Comments and Recommendations contained in the Report of Examination (as of December 31, 2000), and makes the following responses. In general, corrections or changes in procedure required by the report already have been put into place. There are some matters about which the Company disagrees with the report's findings, and these are described below.

INSTRUCTIONS

1. Inadequate accounts and records

The Company has made the necessary correction or change in procedure.

2. Loss and loss adjustment expenses

The Company will continue to regularly review its reserves and will continue to respond appropriately to changes in loss development.

3. Investments in foreign securities

The Company is complying with the requirements of Special Consent Order No. 96, issued by the Office of the Insurance Commissioner on December 20, 2002.

4. Insurer Holding Company Act violation

Within the Safeco group of companies and pursuant to the operation of existing intercompany agreements, we view employees who perform investment activity as employees of the entity for which they are performing investment services. For this reason, we believe it unnecessary to have an investment services agreement between the companies. However, the Company will comply with the instruction that a specific written agreement for investments be implemented.

5. Holding company securities transactions reporting

The Company has made the necessary correction or change in procedure.

6. Errors in annual statements

The Company has made the necessary correction or change in procedure.

7. Promissory note from affiliate

The Company asks that the Department reconsider this finding. The Company is party to an intercompany loan agreement, approved by the Department. This loan to General America Corporation is within the lending limits applicable to that agreement and should therefore be considered 100% admitted. The Company had viewed this promissory note as an intercompany loan for which additional notification to the Department was not required. The Company will in the future treat this and similar transactions as mortgage loans under the Code, but believes that, due to its good faith opinion as to the applicability of the intercompany loan agreement, this asset should be admitted (\$42,786,965).

However, even if this loan were treated as a mortgage loan and so limited to 75% of the fair value of the property, the remaining 25% (\$14,211,965) falls within the allowable loan limits of the existing intercompany lending agreement, and so should be treated as admitted.

8. Bonds – Amortization

The Company believes its amortization schedules are valid. The schedules were derived from an accounting model in PAM, an accounting system used by major insurers around the country. The Company notes that the total variance between the amortized cost shown in the exam report and the PAM schedule's amortized cost is 0.007%.

9. Bonds pledged for letter of credit

The Company can report that all collateral supporting the letter of credit has been returned to the Company, and the letter of credit has been retired. Safeco Corporation has provided the security required for the Safeco UK letter of credit.

The Company had provided the security because its business plan at that time, which involved significant large commercial operations, caused management to view Safeco's UK operations as providing additional market capacity for the Company's large commercial customers, many of whom had foreign operations. The Company therefore concluded that it had the appropriate business interest in this affiliate's activities to justify providing the security. With the re-focus of Safeco Business Insurance to small- to medium-sized businesses, the need for this international capacity no longer exists.

10. Stock valuations

The Company has made the necessary correction or change in procedure, but takes exception to Item (c) for the following reasons:

Item (c): The Company asks that the Department reconsider this finding. The Company views these investments as investments in trusts managed by Impact Community Capital LLC. The Company did not purchase an obligation of, or an interest in, Impact, and so this was not a corporate obligation under RCW 48.13.050. It also was not a prohibited investment under RCW 48.13.270, and therefore should be considered an admitted asset.

Even if one were to view these as an investment in a corporate obligation under RCW 48.13.050, the investment should be considered an admitted asset by virtue of the operation of RCW 48.13.275. In 2000, the mortgage backed securities investment totaling \$2,687,767 was rated AAA by S&P. SVO rules equate this to a rating of 1 (with provisional exemption). An additional \$493,895 note was rated BBB by S&P in 2000, which equates to an SVO rating of 2. As a result, both were quality investments under RCW 48.13.275, and should be admitted (\$3,181,662).

11. Safeco Surplus Lines Insurance Company

The Company agrees that BNY Western Trust Company did not confirm the asset during the examination despite repeated requests, and has informed BNY Western that this is not acceptable. Regarding the absence of a CUSIP number, the Company notes that AIP Commercial Paper does not have a CUSIP because it is not a publicly traded fund.

12. Cash and short-term investments

The Company has made the necessary correction or change in procedure.

13. Other invested assets

The Company asks that the Department reconsider this finding. The Company believes it accurately reported the value of the Pequot Private Equity Fund III LP investment. As of the time of 2000 Annual Statement filing, the information available to the Company indicated the investment had a value of \$1,539,750. It was not until after that filing that the Company received the Partner's audited financial statement and Schedule K-1, showing the capital account amount of \$1,426,454 for the period July 3 through December 31, 2000. At all relevant times, therefore, the Annual Statement value of \$1,539,750, reported by the Company on Schedule BA Part 1 for the year 2000, was correct based on the information available at the time of filing.

14. Receivable/payable securities

Corrective action was taken as of 3/31/2001, to balance accounts receivable and accounts payable. The Company disagrees with this finding only to note that the receivable figure was \$785,058, and not the \$1,539,750 stated in the examination report.

15. Agents' balances or uncollected premiums

The Company has made the necessary correction or change in procedure.

16. Accrued interest on investments

The discrepancy noted in paragraph 1 is explained as follows: The Company correctly classified accrued interest of \$163,000 for CUSIP 136021VD4, CA ST Taxable GU, as a "Short-Term Investment" on Schedule DA, Part 1, but incorrectly included it with bonds on the underwriting and investment exhibit Part 1, page 6. Corrective action has been taken.

The Company asks that the amount disallowed due to the four noted reporting errors be reduced from \$100,719 to \$23,005, and that the difference of \$77,714 be admitted. The discrepancy noted in paragraph 3 is due to inaccurate reporting of dividends declared and unpaid on common stock on Schedule D, Part 2, Section 2. The Company will take steps to prevent such errors in the future. However, the correct figure, \$800,331, is stated in Part 1, page 6 of the 2000 Annual Statement. The Company does, in fact, have adequate documentation supporting the \$800,331 figure. The Company believes that the clerical error on Schedule D should not take precedence over the accurate reporting at Part 1, page 6, and so the difference of \$77,714 should be treated as admitted as it is supported by documentation.

17. Prepaid guaranty fund surcharges

The Company has made the necessary correction or change in procedure.

18. Unsecured advances to agents

The Company asks that the Department reconsider this finding. The Company believes these are not appropriately classified as "unsecured advances to agents." In 1997, the Company invested \$360,000 in its affiliated operations at Safeco Lloyds Insurance Company, a Texas company on the Lloyds plan. There is a written trust agreement between the Company and each individual underwriter at Safeco Lloyds, and adequate protection of these funds by virtue of the operation of the trust agreements. The total should therefore be treated as an admitted asset.

19. Safeco UK limited capacity purchase

The Company has made the necessary correction or change in procedure.

20. Payable to parent, subsidiaries and affiliates

The Company has made the necessary correction or change in procedure.

21. Incomplete and incorrect finance committee minutes

The Company has made the necessary correction or change in procedure.

22. Safekeeping of securities

The custody agreement was revised on July 23, 2001, and amended on August 23, 2001, to comply with NAIC guidelines.

23. Incomplete and incorrect finance committee minutes

The Company has taken steps to ensure proper records of finance committee minutes are maintained.

COMMENTS AND RECOMMENDATIONS

1. Investment guidelines

The Company is reviewing the proposal that it maintain both individual company investment guidelines as well as individual state investment guidelines. The Company notes that it monitors investments for compliance with the Washington Code, and that this is a specific responsibility of the Corporate Finance compliance analyst. Corporate Finance has developed a comprehensive surveillance system to ensure that all Washington insurance company investments comply with the Washington investment code.

2. Securities Lending Agreement

(a) Collateral requirement

According to SSAP 25b, the 105% collateral requirement applies when "the denomination of the currency of the collateral is other than the denomination of the loaned foreign securities." That 105% collateral requirement does not apply to the loaned securities at issue because they were denominated in U.S. currency.

(b) Broker names

The Company believes it does loan securities only to listed brokers, and will review the recommendation for a process in connection with name changes.

Respectfully submitted,



Christine B. Mead
Senior Vice President and Secretary